



March 2012

Volume 1 Issue 1

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**The mission of the Office of the Kansas Securities Commissioner is to protect and inform Kansas investors; to promote integrity, fairness, and full disclosure in financial services; and to foster capital formation.**

## **2012 LEGISLATION INFO**

**T**he Office of the Securities Commissioner has introduced SB 349 for the 2012 legislative session. The bill implements some of the most significant changes in the Kansas Uniform Securities Act since its passage in 2005. Among other things, the bill would provide new authority for the Commissioner to make or authorize transfers of funds from the Securities Act Fee Fund to the Investor Education Fund up to a maximum transfer of \$500,000 per year.

Ordinarily, fines and settlements provide the source of revenues for the Investor Education Fund, but those receipts are not predictable or definite, so the proposed amendment would enable

adequate funding of investor and entrepreneur education programs to continue in the absence of substantial fine and settlement revenues.

The bill would also provide the creation of a Securities Litigation Fund to be used for the costs of trials, other court proceedings and administrative hearings for enforcement of the act. The most significant aspect of this proposal is that it would provide funding to be available to county and district attorneys and state courts so that litigation is feasible in relation to budget constraints of the judicial system. Currently, some cases cannot be prosecuted if the county prosecutors and courts

do not have sufficient funding to cover costs of hearings and trials. Finally, the bill would create a new Securities Restitution Fund. This new fund would be administered by the Commissioner in order to provide a source of funding for making restitution payments to Kansans who have been awarded damages in connection with alleged or adjudicated violations of the act and regulations. Currently, many investors who suffer losses due to violations of the act do not receive any restitution, so the proposed fund would enable at least some recovery of investment losses resulting from illegal offerings or unethical conduct of persons who sell securities or provide investment advice.



## INVEST KANSAS EXEMPTION

IKE is a new exemption that reduces the regulatory hurdles for small businesses and organizations based in Kansas. This exemption is intended to save entrepreneurs, especially in rural Kansas, thousands of dollars and substantial time that it takes to register an offering with KSC.

The most significant requirements for the exemption are: the issuer must be based in Kansas and organized under Kansas law by registration with the Kansas Secretary of State; all offers and sales must occur within Kansas to Kansas residents, and any resales within nine months after the offering must be limited to Kansas residents, the aggregate offering is limited to \$1,000,000 less the amount of other securities sold within the previous 12 months; the investment amount per investor is limited to \$1,000 unless they qualify as an "Accredited Investor" as defined under Regulation D, Rule 501; the

issuer must comply with SEC Rule 147 for an intrastate offering; and Form IKE must be filed with the KSC before use of any general solicitation or the 25th sale in Kansas, whichever occurs first.

Anybody considering an IKE offering are encouraged to confer with KSC staff. No specific form of disclosure document is required for exemption. However, the IKE offerings are still subject to the anti-fraud provisions of state and federal laws. Therefore, complete and accurate information should be provided to investors. Other exemptions from registration with limitations on the number of securities transactions or types of investors are available under The Kansas Uniform Securities Act and Regulations and can be explained further by KSC staff.

## IN THE NEWS

### PRISON ORDERED FOR KC MAN WHO CREATED OWN BANK AND PROMISSORY NOTES

A federal judge sentenced a Kansas City man to 10 years in prison for selling bogus financial products. Denny Ray Hardin, 52, operated the so-called "Private Bank of Denny Ray Hardin" out of his home, selling what he described as a "bonded promissory note" that was guaranteed by the Federal Reserve Bank. Hardin sold almost 2,000 notes to more than 500 people. The Bank charged a fee for the notes, which Hardin pocketed to buy a house and pay off his student loans. U.S. District Judge Gary Fenner concluded that the intended loss from Hardin's scheme was more than \$100 million. That figure, and the large number of victims, increased Hardin's possible sentence under federal guidelines to over 33 years. Both Fenner and prosecutors felt such a sentence would overstate the severity of Hardin's crime. Nevertheless, the judge said he deserved a substantial prison term. "People who were in desperate circumstances turned to you for help and it made their situation worse," Fenner said. Hardin said he never intended to defraud anybody.

## UPCOMING IA SWITCH

The Dodd-Frank Wall Street Reform and Consumer Protection Act set in motion a change for many mid-sized investment adviser firms. Under the law, approximately 3,200 mid-sized investment adviser firms with assets under management between \$25 million and \$100 million will switch from federal to state regulation. The switch will affect investment advisers with assets under management between \$25 million and \$100 million with a principal office and place of business in Kansas that are registered and subject to examination. The Office of the Securities Commissioner is working diligently to ensure a seamless, comprehensive and effective switching process.

Most advisers should be able to make the switch without interfering with their daily business operations. Firms switching to state regulation for the first time can expect thorough inspections generally on a more frequent basis than they may have had experienced before. Most advisers should find that thorough inspections and strong internal compliance benefit customer and firm alike. Investment adviser clients will benefit by knowing who is examining a firm's documents and having an accessible regulator to contact should problems arise. Investment advisers no longer eligible for SEC registration will have until June 28, 2012 to complete the switch to state registration.



# COMPLEX SECURITIES WARRANT INCREASED OVERSIGHT

The Office of the Securities Commissioner, along with other government agencies and self-regulatory organizations has seen an increase in the sale of complex securities. With the increase in the marketing and sale of these products, a corresponding increase in compliance deficiencies and investor complaints has occurred as well.

A complex product may include a security or investment strategy with novel, complicated or intricate derivative-like features, such as structured notes, inverse or leveraged exchange-traded funds, hedge funds and securitized products,

such as asset-backed securities. These features may make it difficult for a retail investor to understand the essential characteristics of the product and its risks, including the possibility that the product will not perform as many investors anticipate, or that it might be inappropriately sold on the basis of enhanced yield, principal protection or the tracking of an index or a reference asset.

In many cases, this office has examined firms that had no written procedures for vetting these products or supervising the sale and marketing of the products to retail investors. Our office has expressed con

cern about complex products to many of the firms and individuals we regulate and have devoted more resources to the issues presented by complex products.

We will continue to review compliance deficiencies involving complex products, addressing conduct such as the misrepresentation of complex investments as appropriate for retail investors seeking safe investments, fraud in collateralized debt obligation marketing materials, and misrepresentations about the extent to which an investment exposes the owner to the subprime real estate market.

## THE LOOKOUT TOP INVESTOR TRAPS FOR 2012



- **Energy Investments-Con** artists continue to attempt to trick investors by using high-pressure marketing tactics touting the aura associated with untapped oil and gas reserves and huge production runs. Even true oil and gas investments almost always have a high degree of risk. Investors need to realize that the possibility that they could lose their total investment even in legitimate ventures is high. Energy investments are poor alternatives for people who are planning for retirement, and or anyone who cannot afford to strike out, when trying to become rich.
- **Gold-Higher** precious metal prices and the promise of an ever-appreciating, “tangible” asset have lured unsuspecting investors into a variety of scams. Many of the recent schemes are variations of old schemes. In most cases with gold and or precious metals, investors suffer heavy losses. Even in legitimate markets there are no guarantees.
- **Promissory Notes**-Investors seeking safety in uncertain economic conditions or those tempted by the promise of big returns through a private, informal loan arrangement may suffer deep losses investing in unregistered or fraudulent promissory notes. These notes give investors a false sense of security with promises or guarantees of fixed interest rates and safety of principal. However even authentic notes carry some risk that the issuers may not meet their obligations. Often times the seller/borrower are not properly registered.
- **Private Placements**-Investors should be aware that, even in the case of legitimate issuers, private placement offerings are highly unlikely to produce ample results, lack clarity and do not have regulatory oversight. Rule 506 of Regulation D is continuously abused by criminals



## CHANGES IN THE OFFICE

The Office of the Securities Commissioner is pleased to announce important new changes to our staff this year. As our office continues to prosper and grow, we strive to meet the needs of our constituents. We are dedicated to protecting the interests of the citizens of Kansas and we believe our changes will strengthen our vigilance against securities fraud and other crimes. We are pleased to announce the promotion of the following staff members: Randy Mullikin, Director of Compliance; Erin Hoestje, Assistant Director and Senior Attorney—Compliance; and Wiley Kannarr, Corporate Finance Counsel.

New to the legal staff is: Jeffrey Kruske, General Counsel; and Josh Ney, Staff Attorney. The compliance staff has added: Caleb Crook, Attorney-Examiner; Courtney Hadley, Attorney-Examiner; and Jason Vinsonhaler, Examiner. New to the enforcement staff is: Chad Entsminger Special Agent; Jennifer Flott, Special Agent. Others new to the staff are Whitney Whitson, Communications Specialist; and Patricia Lightner, Director of Government Relations.

## MEET THE COMMISSIONER



Over the course of the last year Aaron has introduced legislation and regulations aimed at increasing investor protection, investor education, and has been proactive in supporting and increasing capital formation in Kansas

Aaron Jack was appointed Commissioner by Governor Brownback in January 2011. Aaron resides in Topeka, with his wife Anne, and his two young daughters, Kate and Claire.

Aaron began his career in the financial services industry thirteen years ago as a wholesaler for Jackson National Life Distributors, Inc. While residing in Santa Monica, California, he consulted with over 400 financial planners as a brokerage manager. Five years later, Aaron joined New York Life where he worked part of the Individual Annuity Department as its West-Central Zone divisional director.

His responsibilities included promoting annuity and mutual funds sales in over thirty offices. His 3,200 registered reps produced over \$1.5 billion in sales annually and he was the first director in the history of New York Life to raise \$1 billion in new assets for its investment management subsidiary. His unique success led him to be named as the Individual Annuity Department's spokesperson on the Guaranteed Lifetime Income Product Development Committee in New York. Prior to being appointed Kansas Securities Commissioner, Aaron had just been elected to serve a second term in the Kansas House of Representatives for the 99th District. During his time in the legislature, he served on the Commerce and Labor, Health and Human Services, Federal and State Affairs, and Judiciary committees.

Aaron holds a law degree from Washburn University, a Masters of Business Administration from Friends University, and completed his undergraduate education at the University of Kansas.